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SUBJECT: EGYPT: MONETARY POLICY ON TRACK

REF: Cairo 2957

1. (U) In early June, the Central Bank of Egypt (CBE) published the minutes of the first meeting of the Monetary Policy Coordinating Council on April 10 (reftel). According to Banking Law 88 of 2003, the CBE must implement a monetary policy that targets price stability as its main objective, implementing the policy in coordination with other GOE entities. The minutes of the April 10 meeting indicate that the CBE plans to achieve low inflation rates in the medium term by managing, in the transitional period, short-term interest rates and other factors influencing inflation, while also monitoring credit and money supply developments. To accomplish this, the CBE set the overnight deposit rate and the overnight lending rate at 9.5 and 12.5% respectively, reducing overnight interest rates from their current level (Note: The overnight rate dropped from 10.69% on June 1 to 9.77% on June 14. End note). The minutes of the meeting indicate that the CBE believes "real negative interest rates are inconsistent with ongoing efforts to reduce inflation rates".

2. (U) In the press release that accompanied publication of the minutes, the CBE stated that Egypt's economic recovery was continuing and real output growth was gradually approaching its target rate, which was projected at 5% for fiscal year 2005/2006. According to the CBE, inflation has dropped in the first quarter of 2005 due to the CBE's tight monetary policy supported by a stable foreign exchange market. The CBE announced it "intends to put in place a complete inflation targeting framework once the prerequisites are met".

3. (U) In December 2003 the CBE announced that it would pursue an inflation-targeting policy and began preparations for its implementation. Following the appointment of a new CBE Governor in December 2004, preparations continued to pave the way for the inflation-targeting policy framework. Preparations included the launching of an interbank foreign exchange market and aggressive open market operations by the CBE to manage liquidity in the banking sector, strengthened by activation of the primary dealers system for government securities in July 2004. Members of the Monetary Policy Coordinating Council were named in January 2005 and the Council is scheduled to meet on the first Thursday of each month.